

**The Internal Revenue Service's Levy Process
Can Be Improved to Ensure Compliance
With the Internal Revenue Code**

March 2002

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This report has cleared the Treasury Inspector General for Tax Administration disclosure review process and information determined to be restricted from public release has been redacted from this document.



DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

INSPECTOR GENERAL
for TAX
ADMINISTRATION

March 29, 2002

MEMORANDUM FOR COMMISSIONER, WAGE AND INVESTMENT DIVISION
COMMISSIONER, SMALL BUSINESS/SELF-EMPLOYED
DIVISION

A handwritten signature in cursive script, reading "Pamela J. Gardiner".

FROM: Pamela J. Gardiner
Deputy Inspector General for Audit

SUBJECT: Final Audit Report - The Internal Revenue Service's Levy
Process Can Be Improved to Ensure Compliance With the
Internal Revenue Code (Audit # 200110021)

This report presents the results of our review of the processing of levies when closing a case as currently not collectible (CNC) due to economic hardship. The overall objective of this review was to determine if the Internal Revenue Service (IRS) is complying with the Internal Revenue Code (I.R.C.) when processing levies on cases closed as CNC due to economic hardship.

The Congress believed that taxpayers should not have collection activity taken against them once the IRS has determined that the tax owed is uncollectible. As a result, the Congress included a provision in the IRS Restructuring and Reform Act of 1998 (RRA 98)¹ that added I.R.C. § 6343(e) (2000), requiring the IRS to release a wage levy as soon as practicable upon agreement with the taxpayer that the tax is not collectible. A different provision, I.R.C. § 6343(a) (2000), requires the IRS to release a levy when it determines that the levy is creating an economic hardship to the taxpayer.

In summary, we determined that the IRS is not always releasing levies as required by the I.R.C. or the intent of the law because we identified cases in which the IRS received levy payments after the CNC (hardship) determination. In addition, we identified cases that should not have been closed as CNC (hardship) because the IRS either did not

¹ Pub. L. No. 105-206, 112 Stat. 685 (codified as amended in scattered sections of 2 U.S.C., 5 U.S.C., 5 U.S.C. app., 16 U.S.C., 19 U.S.C., 22 U.S.C., 23 U.S.C., 26 U.S.C., 31 U.S.C., 38 U.S.C., and 49 U.S.C.).

determine that an economic hardship existed or appeared to disregard the taxpayer's ability to make payments. Finally, we identified numerous cases that had non-levy payments erroneously recorded as levy payments on the IRS' management information system.

We recommended that the IRS improve controls to ensure IRS personnel identify levies at the time a case is closed as CNC (hardship) and release levies as required. In addition, the IRS should strengthen procedures to ensure cases are closed as CNC (hardship) only when appropriate. Finally, the IRS should clarify guidelines to ensure payments received by IRS personnel are accurately coded on the IRS' computer system.

Management's Response: IRS management has agreed to the recommendations presented and is proposing a number of actions to address the problems identified in our report. These proposed actions include procedural and systemic changes to help ensure levies are properly released. Furthermore, IRS management plans to strengthen guidance on the appropriate use of hardship closing codes and for managers to ensure a hardship condition exists prior to approving a CNC (hardship) determination. IRS management also plans to issue a memorandum that reiterates the need to follow procedures when applying levy payments. Management's complete response to the draft report is included as Appendix VI.

Copies of this report are also being sent to the IRS managers who are affected by the report recommendations. Please contact me at (202) 622-6510 if you have questions or Daniel R. Devlin, Assistant Inspector General for Audit (Headquarters Operations and Exempt Organizations Programs), at (202) 622-8500.

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The Internal Revenue Service's Levy Process Can Be Improved to Ensure Compliance With the Internal Revenue Code

Background

The Internal Revenue Code (I.R.C.) § 6331 (2000) authorizes the Internal Revenue Service (IRS) to collect taxes by levy¹ upon a taxpayer's property or rights to property if the taxpayer neglects or refuses to pay the tax within 10 days after receiving a notice and demand to pay the tax. The IRS can levy a taxpayer's salary and wages, bank accounts, or other money that is owed to the taxpayer.

The I.R.C. § 6343 (a) (2000) requires the IRS to release a levy when it determines that the levy is creating an economic hardship due to the financial condition of the taxpayer. This provision covers all types of levies; however, it does not specify when the levy must be released. If a taxpayer's income does not exceed necessary living expenses and the taxpayer does not have the ability to pay the tax owed, the IRS can close a case as currently not collectible (CNC) due to economic hardship.

Some taxpayers contended the IRS was not immediately releasing wage levies at the time the CNC (hardship) determination was made but collected at least one period of wages before releasing the levy. The Congress believed that taxpayers should not have collection activity taken against them once the IRS has determined that the tax owed is uncollectible. As a result, the Congress included a provision in the IRS Restructuring and Reform Act of 1998 (RRA 98)² that added I.R.C. § 6343(e) (2000) requiring the IRS to release a wage levy as soon as practicable upon agreement with the taxpayer that the tax is not collectible. This provision applies only to wage levies imposed after December 31, 1999. We believe the intent of the law could also apply to restricting the imposition of any new levies on a taxpayer immediately after a CNC (hardship) determination.

¹ When initial contacts by the IRS do not result in the successful collection of unpaid taxes, the IRS has the authority to work directly with financial institutions and other parties to obtain funds that are owed to the taxpayer. This procedure is commonly referred to as a "levy."

² Pub. L. No. 105-206, 112 Stat. 685 (codified as amended in scattered sections of 2 U.S.C., 5 U.S.C., 5 U.S.C. app., 16 U.S.C., 19 U.S.C., 22 U.S.C., 23 U.S.C., 26 U.S.C., 31 U.S.C., 38 U.S.C., and 49 U.S.C.).

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The CNC (hardship) closing action stops IRS personnel from actively working the case and suspends collection action until a taxpayer's ability to pay improves. An IRS report shows that during Fiscal Year (FY) 2001, the IRS closed approximately 207,461 taxpayer accounts as CNC (hardship), with over \$2.2 billion in taxes owed.

Revenue officers work in the Collection Field function (CFf) and make personal (i.e., face-to-face) contact with taxpayers. The Integrated Collection System (ICS) is used to track collection actions taken on taxpayers' accounts by CFf personnel. IRS employees who only make telephone contact with taxpayers work in Automated Collection System (ACS)³ call sites in IRS Customer Service offices. The ACS is used in the call sites to track collection actions taken on taxpayers' accounts.

In FY 2000, the IRS filed 215,946 levies,⁴ of which 141,049 (65 percent) levies were issued through the ACS and 74,897 (35 percent) levies were issued through the ICS.

The IRS initiated several actions to ensure compliance with I.R.C. § 6343(e), including the revision of internal guidelines and the enhancement of the ICS to alert IRS personnel when a wage levy should be released prior to closing a case as CNC (hardship).

The audit was performed at the IRS National Headquarters Small Business/Self-Employed (SB/SE) Division and the Wage and Investment (W&I) Division. Audit work was performed from April through November 2001 in accordance with *Government Auditing Standards*. Detailed information on our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.

³ The ACS is a computerized inventory of taxpayers who have received notices informing them they have not paid their taxes or filed returns.

⁴ Statistics are for all types of levies; the IRS does not maintain separate statistics for wage levies.

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Levies Are Not Always Being Released as Required by the Internal Revenue Code

Based on our detailed analysis of 330 cases⁵ worked by the CFf and/or ACS, we determined that the IRS is not always releasing levies for tax accounts placed in CNC (hardship) status as required by I.R.C. § 6343 (a) or (e), or the intent of the law. We identified 15 cases in which the IRS collected approximately \$19,400 as a result of levy payments received after the CNC (hardship) determination. In these cases, the IRS was collecting levy payments for taxpayers who were facing an economic hardship situation.

In the 15 exception cases, 2 involved a wage levy issued after December 31, 1999, and could be a violation of taxpayers' rights. For the remaining 13 cases, taxpayer burden was adversely affected by the failure to timely release the levy. These 13 cases involve burden to the taxpayer rather than a potential violation of taxpayers' rights because there is no time frame in I.R.C. § 6343 (a) for the IRS to release the levy after a CNC (hardship) determination.

In addition, neither the Treasury Inspector General for Tax Administration nor IRS officials could determine if levies were properly released after the case was closed as CNC (hardship) on 46 cases because insufficient IRS levy data were available. As a result of the insufficient data, we were unable to determine if these cases involved levies (wage or non-wage) or voluntary payments. If these payments were the result of wage levies, the IRS could have violated taxpayers' rights.

Overall, we identified 2 primary deficiencies that contributed to the incorrect handling for 12 of these 15 cases. Specifically:

- The ACS does not systemically notify examiners of open levies when they close a case as CNC (hardship). Instead, examiners must review ACS case history information to determine if a levy release is required - (three cases).

⁵ See Appendix V for the overall results of the detailed analysis.

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- The ICS levy process does not always ensure levies are released as required - (nine cases).

The remaining three exception cases occurred due to isolated circumstances.

The ACS does not systemically identify open levies when a case is closed as CNC (hardship)

In 3 of the 15 exception cases, ACS personnel issued the levy and subsequently closed the case as CNC (hardship). The ACS histories on these three cases reflected the issuance of a levy, but there was no indication that the applicable tax examiners considered releasing the levy prior to closing the case as CNC (hardship). There is no systemic prompt in the ACS, similar to the warning message displayed on the ICS, to alert personnel of the need to release a levy prior to closing a case as CNC (hardship).

In 1 of the 3 cases, 12 wage levy payments, totaling \$900, were received over a 1-year period after the case was closed as CNC (hardship).

The ICS levy process does not always ensure levies are released as required

CFf personnel are not always releasing levies prior to closing cases as CNC (hardship). Detailed analysis showed that CFf personnel:

- Did not always effectively identify levies prior to closing cases as CNC (hardship) - (five cases).
- Closed some wage levies rather than releasing them before closing cases as CNC (hardship) - (two cases).
- Did not always release non-wage levies when appropriate before closing cases as CNC (hardship) - (two cases).

CFf personnel did not always effectively identify levies prior to closing cases as CNC (hardship). Two of the 15 exception cases involved a levy issued by ACS personnel but the CNC (hardship) determination was made by CFf personnel. Although the ICS was programmed to display a warning screen for cases closed as CNC (hardship), this

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programming change identifies only wage levies issued by CFf personnel. As a result, the warning screen is not displayed for cases closed as CNC (hardship) if ACS personnel initiated the levy or if CFf personnel issued a non-wage levy.

For example, a case was transferred from the ACS to the CFf with an open ACS levy (although no levy-related payments had been received at the time of the transfer). The CFf employee entered in the ICS case history that it was not in the government's best interest to pursue this low dollar, low priority, and probably uncollectible account any further and closed it as CNC (hardship). No mention was made in the case file of the open ACS levy. However, the first of 5 levy payments was received approximately 2 weeks after the CNC (hardship) action. These 5 levy payments totaled approximately \$1,525 and were received over a 6-month period after the CNC (hardship) action. The tax owed was fully paid after three levy payments; however, the levy payments continued because the levy was not released. Consequently, 2 refund checks, totaling about \$430 (including interest payments), were returned to the taxpayer.

When a case is transferred from the ACS to the CFf, not all ACS case information, including any open levy data, is systemically input to the ICS. As a result, CFf personnel must manually review Integrated Data Retrieval System (IDRS)⁶ information to identify these levies.

In another 3 of the 15 cases where the levy was not released, we could not determine who issued the levy. However, CFf personnel could have performed additional research to identify the levy source and to ensure the levy's release prior to the CNC (hardship) closure.

For example, CFf personnel recorded on the ICS that levy payments were being received but the levy source was unknown. About 2 months after making that entry, the employee closed the case as CNC (hardship) and there was no documentation in the case file that the employee

⁶ IRS computer system capable of retrieving or updating stored information on taxpayers' account records.

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attempted to release the levy. As a result, 6 levy payments, totaling about \$480, were received over a 10-month period after the CNC (hardship) closing. As of September 2001, the levy payments were still being received by the IRS for this case.

Cff personnel closed some wage levies rather than releasing them before closing cases as CNC (hardship).

In 2 of the 15 exception cases, the wage levy payments occurred after the case was closed as CNC (hardship) because Cff personnel closed wage levies on the ICS, rather than releasing the levies as required. When a levy is closed on the ICS, it is removed from active status on the system; however, the levy is still in effect because it has not been released.

In addition to the I.R.C, the Internal Revenue Manual (IRM) requires employees to release the Notice of Levy when the levy is creating an economic hardship. Furthermore, an IRS publication that is usually sent to each taxpayer along with a final bill for the taxes owed states that the IRS must release a levy if the IRS determines that the levy is creating an economic hardship on the taxpayer. In limited situations, Cff personnel can close a levy on the ICS. However, Cff guidelines state that closing a Notice of Levy should not be substituted for issuing a levy release where appropriate.

On one case, the Cff employee closed the wage levy on the ICS after contacting the taxpayer's employer. It appears the ICS warning screen was not displayed when the case was as closed CNC (hardship) because the levy was closed rather than released. As a result, 2 wage levy payments, totaling approximately \$2,700, were received after the CNC (hardship) closing.

On another case, the Cff employee closed the levy in April 2000 and subsequently closed the case as CNC (hardship) because the taxpayer had little income and was on an indefinite leave of absence from the employer. However, the IDRS showed that wage levy payments were received in February and March 2000. There was no indication on the ICS that the Cff employee was aware of the payments. Six wage levy payments, totaling approximately \$1,240, were received prior to the

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CNC (hardship) closing and 6 wage levy payments, totaling about \$815, were received over a 1-year period after the CNC (hardship) closing. It appears the ICS warning screen was not displayed because the levy was closed rather than released.

The IRS is at risk of violating taxpayers' rights by its practice of closing, rather than releasing, levies in these types of cases.

Cff personnel did not always release non-wage levies when appropriate before closing cases as

CNC (hardship). As stated previously, the IRS enhanced the ICS to check for open wage levies when employees close a case as CNC (hardship). However, this warning screen is not displayed for non-wage levies issued by Cff personnel. In 2 of the 15 exception cases, Cff personnel issued a non-wage levy and subsequently closed the case as CNC (hardship). Documentation in the case files did not indicate that Cff personnel considered releasing the non-wage levy.

For example, a Cff employee closed a non-wage levy in June 2000 and closed the case as CNC (hardship) in August 2000. However, 13 non-wage levy payments, totaling approximately \$1,190, were received over a 1-year period after the case was closed as CNC (hardship). As of September 2001, the levy payments were still being received by the IRS for this case.

Recommendations

1. SB/SE Compliance management should take additional actions to ensure that open levies are identified and released as appropriate when ACS personnel close a case as CNC (hardship). Depending on the availability of programming resources, management should consider enhancing the ACS to display a warning message when a case with a levy is closed as CNC (hardship).

Management's Response: The Office of Filing and Payment Compliance, SB/SE, updated its hardship procedures to require employees to document in cases forwarded for manager approval whether a levy release is

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needed. Also, they requested an ACS system change that will result in a levy release reminder message being generated when a CNC (hardship) determination is made.

2. SB/SE Compliance management should ensure that revenue officers review available information to properly identify levies issued by ACS personnel and ensure the levies are appropriately released prior to closing a case as CNC (hardship).

Management's Response: The Office of Filing and Payment Compliance, SB/SE, will update procedures requiring a review of the ACS to determine if levies should be released. In addition, the ACS employees will be instructed to record levy release information on the ACS.

3. Before approving a CNC (hardship) case closure, SB/SE Compliance management should review the case file to ensure levies are released, if appropriate, in compliance with the I.R.C. The revenue officer should document in the case history the reason why a levy was closed rather than released.

Management's Response: The Office of Filing and Payment Compliance, SB/SE, will request an ICS change that will enable revenue officers to document the reason a levy is closed but not released. In addition, procedures will be revised to include a review of the levy disposition prior to the approval of the CNC (hardship) determination.

4. SB/SE Compliance management should research the 46 cases in which insufficient levy data were available to ensure the IRS is complying with I.R.C. § 6343.

Management's Response: The Office of Filing and Compliance, SB/SE, will perform additional research on the 46 cases.

Currently Not Collectible (Hardship) Case Closures Are Not Always Appropriate

Based upon our analysis of 330 cases closed as CNC (hardship), we identified a separate issue in 37 (11 percent) cases where the IRS either did not determine that an economic hardship existed or appeared to disregard the taxpayer's ability to make payments. As a result, the cases should not have been closed as CNC (hardship). For example:

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- Twenty-four cases were closed without any case documentation supporting that the IRS contacted the taxpayer and/or obtained current asset or financial information from the taxpayer.
- Ten cases were closed as CNC (hardship) even though the IRS' analysis of each case did not support an economic hardship determination. In these cases, the IRS continued to receive periodic levy payments after the case was closed as CNC (hardship).
- Three cases were closed by the group manager without any documented case research or assignment to a revenue officer.

The IRS' policy provides for removing a delinquent tax account from active inventory if, after all required steps in the collection process have been taken, the account is determined to be currently not collectible. Before closing a case as CNC (hardship), IRS personnel are required to obtain and analyze information on the taxpayer's assets, and the taxpayer's financial information if the taxpayer's liability exceeds a certain dollar amount. Currently not collectible determinations generally require the approval of the immediate manager to ensure the investigation met established standards.

If the IRS determines that the taxpayer has some ability to pay or agrees to make payments, various collection options can be considered, including installment agreements. However, as of April 1998, the IRS could no longer accept an installment agreement if it would not fully pay the tax liability before the collection statute expiration date (CSED).⁷ The I.R.C. § 6502 (2000) prohibits the IRS from taking further collection activity after a collection statute expires.

⁷ The CSED is the last date to collect delinquent taxes without filing a suit for judgment. It is usually 10 years from the date taxes were assessed.

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IRS Compliance management believed that some of the 37 cases were closed as CNC (hardship) because installment or levy payments would not satisfy the tax liability before the CSED. As a result, an installment agreement or other collection option could not be used to close these cases out of active inventory. The CNC (hardship) closing action was used as an alternate means of removing cases from active inventory. In two cases, wage levy payments continued after the CSED, which could violate taxpayers' rights.

Although we do not know the extent of incorrect CNC case closings, it may adversely affect the accuracy of statistical reports capturing this type of information. IRS management uses these reports for budget planning, program evaluation, operational control, and analysis of resource allocation.

Recommendations

5. SB/SE Compliance management should issue guidelines instructing field personnel how to close cases in which the taxpayer has some ability to pay but the payments will not fully pay the tax liability before the CSED.

Management's Response: The Office of Filing and Payment Compliance, SB/SE, will update procedures to allow installment agreements if at least one of a taxpayer's balance due accounts can be satisfied. In addition, they have requested legislation to allow agreements even if none of a taxpayer's balance due accounts can be fully satisfied, in order to allow monthly payments when taxpayers have the ability to pay.

6. SB/SE Compliance management should ensure that a hardship determination is made before approving cases closed as CNC (hardship).

Management's Response: The Office of Filing and Payment Compliance, SB/SE, will strengthen guidance on the appropriate use of hardship closing codes and for managers to ensure a hardship condition exists prior to approving a CNC (hardship) determination.

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Payments Are Being Erroneously Recorded as Originating from a Levy Action

The IRS' enforcement statistics on revenue generated from levies are inaccurate. Numerous non-levy payments (e.g., voluntary payments from taxpayers) are being erroneously recorded as levy payments. During our analysis of 330 cases closed as CNC (hardship), we identified 197 (60 percent) that had non-levy payments erroneously recorded as levy payments. For these 197 cases, as many as 1,700 payments may have been erroneously recorded as levy payments as of September 30, 2001.

IRS computer systems have been programmed to accept a two-digit Designated Payment Code (DPC) that identifies the source of a payment (e.g., levy, seizures, etc.). Data from this type of input are accumulated on a national basis to determine the revenue effectiveness of specific collection activities.

Collection payments are processed in IRS offices known as campuses. If the payments are the result of an ACS collection action, they are sent directly from the taxpayer or employer to a post office box for an IRS campus. IRS campus personnel, who are not directly involved with the ACS collection activity, process the payment and enter the DPC data. If the payments are the result of a CFf action, they are sent to a CFf employee who completes a payment voucher and enters the DPC data. Because the payments are generally sent to the CFf employee responsible for the collection action, the employee should be able to correctly enter the DPC data. Once the CFf employee is satisfied that the levy payments are being consistently received, responsibility for the payments is transferred elsewhere and the case is usually removed from the active ICS inventory. IRS guidelines require that the IDRS be used to research taxpayers' accounts and verify proper application of payments.

Detailed analysis of the 197 cases with erroneously recorded levy payments showed that 173 (88 percent) involved ACS-related collection actions. Of these 173 tax cases:

- Payments were processed at 3 IRS campuses for 161 (93 percent) cases.

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- Similar payment amounts were recorded not only as a levy but also as either a miscellaneous payment and/or with no DPC for 149 cases.

According to Customer Account Services officials from the W&I Division, the IRM does not provide detailed guidelines for processing ACS levy-related payments. An official from an IRS campus stated that its day shift processes most payments received from the ACS post office box as levy payments while its night shift processes the same type of payments as miscellaneous payments.

Before the ACS can issue a levy, it must issue a Notice of Intent to Levy and a Notice of Your Right to a Hearing to the taxpayer. A Transaction Code (TC) 971, Action Code 69, systemically records the Notice of Intent to Levy on the IDRS. Before levying, ACS personnel are required to check that this transaction code is on each tax period included on the levy. Of the 173 cases involving ACS-related collection actions, 122 (71 percent) did not have the TC 971, Action Code 69 on the tax account. Thus, the payments were most likely not from a levy source. If IRS personnel researched the IDRS for this transaction code, they could better ensure that payments are accurately recorded.

The Office of Revenue Analysis has a project underway involving DPCs. The goal of the project is to be able to respond to potential questions about the correlation between enforcement revenue and specific collection actions, such as levies. As a result of the non-levy payments recorded as levies, the IRS' management information system may not accurately show the amount of revenue collected from the levy process.

Recommendation

7. W&I Customer Account Services management should clarify internal guidelines to ensure the sources of payments are accurately coded on the IRS' computer system.

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Management's Response: Submission Processing, W&I, will issue a memorandum to the field reiterating the need to follow procedures when applying levy payments.

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Appendix I

Detailed Objective, Scope, and Methodology

The overall objective of this audit was to determine if the Internal Revenue Service (IRS) complied with the Internal Revenue Code (I.R.C.) when processing levies on cases closed as currently not collectible (CNC) due to economic hardship. We performed the following tests to accomplish this objective:

- I. Determined the process the IRS uses to impose, release, or prevent levies on CNC (hardship) cases. Specifically, we:
 - A. Determined the I.R.C. § 6343 requirements for processing cases involving both a levy and CNC (hardship) closure.
 - B. Interviewed IRS collection and remittance processing management and analyzed IRS procedures and controls to determine how the IRS processes levies involving cases closed as CNC (hardship).
 - C. Determined if the IRS completed all scheduled action items that were identified as being needed to effectively implement changes to the I.R.C.
 - D. Determined if the IRS monitored compliance with I.R.C. § 6343 for cases involving both a levy and a CNC (hardship) closure.
- II. Determined if the IRS timely released or prevented levies on cases either being closed or recently closed as CNC (hardship).
 - A. Obtained a national computer extract on March 28, 2001, that identified 4,257 cases that had levy and a CNC (hardship) status, both imposed after December 31, 1999.
 1. Reviewed all 292 cases identified in which a levy continued after the case was closed as CNC (hardship).
 - a. Selected a judgmental¹ sample of 210² cases in which either a levy payment continued for over 45 days after the case was closed as CNC (hardship) or more than 1 levy payment was received after CNC (hardship) closure.

¹ Based upon analysis of a national computer extract, we identified cases that appeared to be in non-compliance with I.R.C. § 6343 and decided to include only those cases in our judgmental sample to efficiently use available audit resources.

² Eighty-two cases either had only 1 levy payment received after the CNC (hardship) closure or all levy payments stopped within 45 days of the CNC (hardship) closure. For these cases, we determined that the "as soon as practicable" provision of I.R.C. § 6343(e) was met. We performed detailed analysis on the remaining 210 cases that had more than 1 levy payment or the levy payments continued beyond the 45 days.

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2. Reviewed all 176 cases in which a levy was imposed within 30 days after the case was closed as CNC (hardship).
 - a. Selected a judgmental³ sample of 120⁴ cases in which either a levy payment continued for over 45 days after the case was closed as CNC (hardship) or more than 1 levy payment was received after the CNC (hardship) closure.
- B. Determined the amount of the inappropriate levy payments received during the period January 1, 2000, through September 30, 2001, for the exception cases identified in Audit Steps II.A.1. and II.A.2.

³ Based upon analysis of a national computer extract, we identified cases that appeared to be in non-compliance with I.R.C. § 6343 and decided to include only those cases in our judgmental sample to efficiently use available audit resources.

⁴ Although the 176 cases had a levy payment start within 30 days after the case was closed as CNC (hardship), 56 cases either had only 1 levy payment received after the CNC (hardship) closure or all levy payments stopped within 45 days of the CNC (hardship) closure. For these cases, we determined that the intent of I.R.C. § 6343 was met. We performed detailed analysis on the remaining 120 cases that had more than 1 levy payment or the levy payments continued beyond the 45 days.

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Appendix II

Major Contributors to This Report

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Appendix III

Report Distribution List

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Director, Customer Account Services, Wage and Investment Division W:CAS

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Appendix IV

Outcome Measures

This appendix presents detailed information on the measurable impact that our recommended corrective actions will have on tax administration. These benefits will be incorporated into our Semiannual Report to the Congress.

Type and Value of Outcome Measure:

- Taxpayer Rights – Potential; 2 taxpayer accounts in which wage levy payments totaling approximately \$3,500 were not released after the cases were closed Currently Not Collectible (CNC) due to economic hardship (see page 3).

Methodology Used to Measure the Reported Benefit:

We obtained a computer extract on March 28, 2001, that identified 4,257 cases the Internal Revenue Service (IRS) both imposed a levy on and closed as CNC (hardship) after December 31, 1999. Using this extract, we judgmentally sampled 210 cases in which either a levy payment continued for over 45 days after the case was closed as CNC (hardship) or more than 1 levy payment was received after the CNC (hardship) closure. In addition, we judgmentally sampled 120 cases in which a levy payment was imposed within 30 days of the case being closed as CNC (hardship) and either a levy continued for over 45 days or more than 1 levy payment was received after the CNC (hardship) closure. Based upon this detailed analysis of 330 cases, we identified 2 cases in which the IRS did not release wage levies as required by Internal Revenue Code (I.R.C.) § 6343 (e). For these two cases, we researched the Integrated Data Retrieval System to identify levy-related payments received by the IRS after the case was as closed CNC (hardship).

Type and Value of Outcome Measure:

- Taxpayer Burden – Actual; 13 taxpayer accounts in which levy payments totaling approximately \$15,900 were not released after the case was closed as CNC (hardship) (see page 3).

Methodology Used to Measure the Reported Benefit:

We obtained a computer extract on March 28, 2001, that identified 4,257 tax cases the IRS both imposed a levy on and closed as CNC (hardship) after December 31, 1999. Using this extract, we judgmentally sampled 210 cases in which either a levy payment continued for over 45 days after the case was closed as CNC (hardship) or more than 1 levy payment was received after the CNC (hardship) closure. In addition, we judgmentally sampled 120 cases in which a levy payment was imposed within 30 days of the case being closed as CNC (hardship) and either a levy continued for over 45 days or more than 1 levy payment was received after the CNC (hardship) closure. Based upon this detailed analysis of the 330 cases, we identified

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13 cases in which the IRS did not release levies as required by I.R.C. § 6343 (a). For these 13 cases, we researched the Integrated Data Retrieval System to identify levy-related payments received by the IRS after the case was closed as CNC (hardship).

Type and Value of Outcome Measure:

- Reliability of Information – Actual; 37 taxpayer accounts that were inappropriately closed as CNC (hardship) (see page 8).

Methodology Used to Measure the Reported Benefit:

We obtained a computer extract on March 28, 2001, that identified 4,257 cases the IRS both imposed a levy on and closed as CNC (hardship) after December 31, 1999. Using this extract, we judgmentally sampled 210 cases in which either a levy payment continued for over 45 days after the case was closed as CNC (hardship) or more than 1 levy payment was received after the CNC (hardship) closure. In addition, we judgmentally sampled 120 cases in which a levy payment was imposed within 30 days of the case being closed as CNC (hardship) and either a levy continued for over 45 days or more than 1 levy payment was received after the CNC (hardship) closure. Based upon this detailed analysis of 330 cases, we identified 37 taxpayer accounts cases that should not have been closed as CNC (hardship).

Type and Value of Outcome Measure:

- Taxpayer Rights – Potential; two taxpayer accounts in which wage levy payments continued after the collection statute expiration date (see page 8).

Methodology Used to Measure the Reported Benefit:

We obtained a computer extract on March 28, 2001, that identified 4,257 cases the IRS both imposed a levy on and closed as CNC (hardship) after December 31, 1999. Using this extract, we judgmentally sampled 210 cases in which either a levy payment continued for over 45 days after the case was closed as CNC (hardship) or more than 1 levy payment was received after the CNC (hardship) closure. In addition, we judgmentally sampled 120 cases in which a levy payment was imposed within 30 days of the case being closed as CNC (hardship) and either a levy continued for over 45 days or more than 1 levy payment was received after the CNC (hardship) closure. Based upon this detailed analysis of 330 cases, we identified 2 taxpayer accounts in which wage levy payments continued after the collection statute expiration date.

Type and Value of Outcome Measure:

- Reliability of Information – Actual; 197 taxpayer accounts with payments that were erroneously coded as levy payments on the IRS' computer system (see page 11).

Methodology Used to Measure the Reported Benefit:

We obtained a computer extract on March 28, 2001, that identified 4,257 cases the IRS both imposed a levy on and closed as CNC (hardship) after December 31, 1999. Using this extract,

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we judgmentally sampled 210 cases in which either a levy payment continued for over 45 days after the case was closed as CNC (hardship) or more than 1 levy payment was received after the CNC (hardship) closure. In addition, we judgmentally sampled 120 cases in which a levy payment was imposed within 30 days of the case being closed as CNC (hardship) and either a levy continued for over 45 days or more than 1 levy payment was received after the CNC (hardship) closure. Based upon this detailed analysis of 330 cases, we identified 197 taxpayer accounts that had non-levy payments erroneously coded as levy payments.

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Appendix V

Results of Detailed Case Analysis¹

Non-Compliance With Internal Revenue Code (I.R.C.) § 6343 or the Intent of the Law (see page 3)	15
Complied With I.R.C. § 6343 or the Intent of the Law	35
Insufficient Data to Determine Compliance With I.R.C. § 6343 (see page 3)	46
Improperly Closed As Currently Not Collectible (Hardship) (see page 8)	37
Erroneously Coded As Levy Payment (see page 11)	197
<hr/>	
Total	330


¹ We initially reviewed 468 cases in which the levy continued after the CNC (hardship) determination or the levy was imposed within 30 days of the CNC (hardship) determination. We determined that levy payments stopped within 45 days after the CNC determination in 138 cases. For these cases, we determined that the “as soon as practicable” provision of I.R.C. § 6343(e) or the overall intent of the law was met. We performed detailed analysis on the remaining 330 cases that had more than 1 levy payment or the levy payments continued beyond the 45 days. See Appendix I for additional information on the methodology used to judgmentally sample these cases.

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Appendix VI

Management's Response to the Draft Report

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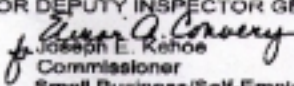


DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

COMMISSIONER
SMALL BUSINESS/SELF-EMPLOYED DIVISION

March 27, 2002

MEMORANDUM FOR DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: 
Joseph E. Kehoe
Commissioner
Small Business/Self-Employed Division

SUBJECT: Draft Audit Report – The Internal Revenue Service's Levy Process Can Be Improved to Better Ensure Compliance With The Internal Revenue Code (Audit No. 200110021)

I reviewed your report and agree we can improve our processing of levies when closing a case currently not collectible (CNC) due to economic hardship. The Restructuring and Reform Act of 1998 requires us to release a wage levy when closing a case due to economic hardship. While fifteen errors out of over 200,000 levies issued may appear insignificant, I recognize the impact on the affected taxpayers and am committed to bring the error rate as close to zero as possible.

This process is relatively new (effective for levies issued after December 31, 1999), requiring procedural and systemic revision to processes, which were in place on the effective date. We continue to improve our controls and procedures for this process as outlined in the corrective actions in response to your recommendations.

I agree with the outcome measures you describe in Appendix IV of your report. However, we are unable to provide any further relief to the affected taxpayers due to regulatory constraints. It is important to note, however, that the debts were legitimate and the money was applied to the delinquent accounts.

Our comments on the recommendations in this report are as follows:

RECOMMENDATION 1

SB/SE Compliance management should take additional actions to ensure that open levies are identified and released as appropriate when automated collection system (ACS) personnel close a case CNC (hardship). Depending on the availability of programming resources, management should consider enhancing the ACS to display a warning message when a case with a levy is closed CNC (hardship).

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ASSESSMENT OF CAUSE(S)

Procedures require release of levy when closing cases CNC (hardship). In a few instances, miscommunication between an employee recommending a hardship determination and the manager who approved it led to overlooking the release of the levy.

CORRECTIVE ACTIONS

- A. We added a reminder to our hardship procedures about releasing a levy, and now require employees to document in cases forwarded for manager approval whether a levy release is needed.
- B. We also requested an ACS system change resulting in a levy release reminder message "Any Levy Releases Required?" when the employee enters a hardship code into the ACS case history.

IMPLEMENTATION DATE

- A. Completed March 18, 2002
- B. July 1, 2003 (to complete system change)

RESPONSIBLE OFFICIAL(S)

Director, Filing and Payment Compliance
Small Business/Self-Employed

CORRECTIVE ACTION(S) MONITORING PLAN

The staff of the Office of Filing and Payment Compliance, SB/SE will monitor and advise the Director of Filing and Payment Compliance of any delays.

RECOMMENDATION 2

SB/SE Compliance management should ensure that revenue officers review available information to properly identify levies issued by ACS personnel and ensure the levies are appropriately released prior to closing a case CNC (hardship).

ASSESSMENT OF CAUSE(S)

In some cases, revenue officers only reviewed ICS case histories. They did not review automated collection system (ACS) histories for case actions.

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CORRECTIVE ACTIONS

We will add instructions to IRM 5.16 (CNC) requiring case reviews to determine whether we should release levies. The instructions will require a review of ACS and all other prior history entries in search of any levy actions and, in particular, unreleased wage levies. (Note: Only wage levies must be released.) In addition, the ACS IRM will include instruction to ensure that when an employee releases a levy, he or she must record it in the ACS history.

We will instruct field employees to research tax modules prior to reporting accounts uncollectible with hardship closing codes. If transaction codes (TCs) 670 (subsequent payments) with designated payment codes (DPCs) of "05" (levy) are present or, if the system shows a regular series of payments, we will take care to ensure the disposition of levies is known.

IMPLEMENTATION DATE

December 1, 2002

RESPONSIBLE OFFICIAL(S)

Director, Filing and Payment Compliance
Small Business/Self-Employed

CORRECTIVE ACTION(S) MONITORING PLAN

The staff of the Office of Filing and Payment Compliance, SB/SE will monitor and advise the Director of Filing and Payment Compliance of any delays.

RECOMMENDATION 3

Before approving a CNC (hardship) case closure, SB/SE Compliance management should review the case file to ensure levies are released, if appropriate, in compliance with the IRC. The revenue officer should document in the case history the reasons why a levy was closed rather than released.

ASSESSMENT OF CAUSE(S)

Codes within ICS show the reason a levy is closed without being released. The choices show the reasons as "Satisfied," "Continuous Wage," "No Funds," and "Other." Only the first three document the reason the revenue officer closed the levy rather than releasing it.

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CORRECTIVE ACTIONS

- A. We will request an ICS change, so a fourth literal tells the revenue officer to document the reason a levy is "closed," not "released."
- B. We will revise the IRM to include a "disposition of levy" review, prior to approval of hardship CNCs.

IMPLEMENTATION DATE

- A. March 1, 2003
- B. December 1, 2002

RESPONSIBLE OFFICIAL(S)

Director, Filing and Payment Compliance
Small Business/Self-Employed

CORRECTIVE ACTION(S) MONITORING PLAN

The staff of the Office of Filing and Payment Compliance, SB/SE will monitor and advise the Director of Filing and Payment Compliance of any delays.

RECOMMENDATION 4

SB/SE Compliance management should research the 46 cases in which insufficient levy data was available to ensure the IRS is complying with IRC 6343.

ASSESSMENT OF CAUSE(S)

The revenue officer either did not find information from the ACS/ICS archives or the information did not adequately document the reasons why the revenue officer retained levy payments after reporting an account CNC (hardship).

CORRECTIVE ACTIONS

We will conduct additional research on these 46 cases.

IMPLEMENTATION DATE

September 30, 2002

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RESPONSIBLE OFFICIAL(S)

Director, Filing and Payment Compliance
Small Business/Self-Employed

CORRECTIVE ACTION(S) MONITORING PLAN

The staff of the Office of Filing and Payment Compliance, SB/SE will monitor and advise the Director of Filing and Payment Compliance of any delays.

RECOMMENDATION 5

SB/SE Compliance management should issue guidelines instructing field personnel how to close cases in which the taxpayer has some ability to pay, but will be unable to fully pay the tax liability before the CSED.

ASSESSMENT OF CAUSE(S)

In 1998 our legal counsel determined that Internal Revenue Code 6159 provided for installment agreements only if the agreement would fully satisfy all outstanding taxes on a taxpayer's account. Prior to 1998, we granted installment agreements based on taxpayers' ability to pay.

CORRECTIVE ACTIONS

IRM 5.14 now allows installment agreements if the taxpayer can satisfy at least one of his or her balance due accounts. If the taxpayer has multiple accounts and cannot pay at least one balance due account, we direct him or her to submit offers in compromise. We included guidance to consider enforcement action if taxpayers do not submit offers in compromise once requested to do so in these situations. The IRM also provides for agreements that the taxpayer can fully pay by acceptance of one or two large payments at the end of agreements. In addition, we have requested legislation to allow agreements even if the taxpayer cannot fully satisfy any of his or her balance due accounts, in order to allow monthly payments when taxpayers have the ability to pay.

IMPLEMENTATION DATE

May 1, 2002 for publication of IRM; guidelines provided to the field March 15, 2002.

RESPONSIBLE OFFICIAL(S)

Director, Filing and Payment Compliance
Small Business/Self-Employed

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CORRECTIVE ACTION(S) MONITORING PLAN

The staff of the Office of Filing and Payment Compliance, SB/SE will monitor and advise the Director of Filing and Payment Compliance of any delays.

RECOMMENDATION 6

SB/SE Compliance management should ensure that a hardship determination is made before approving cases closed CNC (hardship).

ASSESSMENT OF CAUSE(S)

After Chief Counsel's opinion in 1998 ("Assessment of Cause" for #5), revenue officers sometimes reported accounts uncollectible when there was an ability to pay because an installment agreement could not be approved.

CORRECTIVE ACTIONS

First, we will strengthen the guidance provided in the IRM 5.16 that directs managers to ensure a hardship condition exists prior to approving hardship CNCs. Second, we believe we addressed most of the "gap" case situations that prompted the inappropriate use of closing codes by issuing IRM 5.14. However, we will also post on the ICS Bulletin Board a notice regarding the new IA guidelines and the appropriate use of hardship closing codes.

IMPLEMENTATION DATE

December 1, 2002

RESPONSIBLE OFFICIAL(S)

Director, Filing and Payment Compliance
Small Business/Self-Employed

CORRECTIVE ACTION(S) MONITORING PLAN

The staff of the Office of Filing and Payment Compliance, SB/SE will monitor and advise the Director of Filing and Payment Compliance of any delays.

RECOMMENDATION 7

W&I Customer Account Services management should clarify internal guidelines to ensure the sources of payments are accurately coded on the IRS' computer system.

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ASSESSMENT OF CAUSE(S)

While the IRM provides specific guidelines for processing ACS levy related payments, it appears that employees did not always follow these procedures in the field.

CORRECTIVE ACTIONS

To ensure accurate processing, a Submission Processing Program Analyst and a Small Business Self-Employed (SB/SE) Program Analyst, responsible for Filing Payments and Compliance, reviewed the IRM processing procedures. They identified no major deficiencies. Submission Processing will issue a memorandum to the field reiterating the need to follow procedures, as stated in the IRM, to prevent any local deviations.

IMPLEMENTATION DATE

June 1, 2002

RESPONSIBLE OFFICIAL(S)

Chief, IMF Branch
Director Submission Processing, CAS (Wage & Investment Division)

CORRECTIVE ACTION(S) MONITORING PLAN

Submission Processing will perform a periodic review of the processing of work at campuses to ensure proper coding and input of work. We will use processing feedback received from Service Center Collection Branch (SCCB) to further ensure processing accuracy.

Please call Martha Sullivan, Director, Compliance, Small Business/Self-Employed, at (202) 283-2180, if you have any questions.